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Economic Conditions
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General Business Conditions

THE broadening of activity in the commodity markets, where buyers of many industrial raw materials and semi-finished goods are covering needs well into 1941, has been the principal development in business during the past month. It indicates that hopeful views of the outlook are strengthening, and it commands general attention because of the question whether the war and the defense program will start a price inflation. During the Summer the commodity markets did little. Demands arising from the business upturn were easily supplied, and some of the staples, particularly South American products, were under pressure because normal shipments to the Continent of Europe were suddenly cut off. At the same time the bullish opinions inspired by prospective defense orders were qualified by knowledge that the defense program would take considerable time to get going, and by fears of an imminent British defeat. The result of the battle of Britain is not only important because of the issues and implications for this country, but is a practical element in business and market calculations, inasmuch as the British Empire is now taking two-thirds of our exports, largely war materials.

As time has passed, however, optimism has plainly increased. The confidence of the British people that German bombing will not decide the struggle, and in the outcome if invasion is tried, is supported by the opinions of military observers, and it is communicating confidence to this country. As long as the war goes on the prospect is for larger shipments to Great Britain and the Empire. Even now British purchases and other export increases are more than making up the loss of Continental markets; total U. S. exports in August were $350,000,000, almost back to last Winter's peak, and the trend is upward.

Meanwhile the defense program is having a more direct effect upon business each month. Contract awards are increasing, and although deliveries in many cases will not begin for a long time the preparations are stimulating activity. Programs for plant expansion, for airplanes and engines, tanks, ordnance and explosives, are passing from the design to the construction stage. Army and Navy expenditures are rising, and on the basis of early figures will approximate $225,000,000 for September compared with $202,000,000 in August, $179,000,000 in July, and $109,000,000 in September last year. Apart from the industrial effort, calling of National Guard troops to service and preparations for training the draft army will cause a steady rise in these disbursements.

High Industrial Operations Assured

All these developments have influenced buyers of industrial materials to move more confidently, and the usual tendency of buying to roll up momentum has been evident. It should be recognized that direct orders for defense work still are only a small part of current business. A good part of the new buying represents lengthening of commitments, for the purpose of protection against possible delivery delays or higher prices; and even those who take a temperate view of market prospects have been reluctant to stand aside, and possibly find themselves at a disadvantage, while their competitors were covering ahead. Domestic sales of copper during the month, around 250,000 tons, have broken all records, and fabricators' needs are now covered during a good part of the first quarter of 1941. Sales of fabricated metal products likewise have been heavy. Steel business has been as good as in August, if not better, although steel buying exceeded consumption throughout the Summer and consumers' inventories have increased. The zinc market has been exceptionally active. Lumber orders have reached a point where some mills are limiting sales.

Textiles and other goods of everyday use are being bought to some extent by the Government, and trade buyers have been active. Cotton goods sales have greatly exceeded production. Shoe and leather business has picked up with hide markets rallying strongly.

A buying movement like this naturally disposes of most questions as to the activity of the

industries in the near future. It gives producers of raw materials and of semi-manufactured goods the largest unfilled orders in some time; and in conjunction with the heavy backlogs in durable goods industries, the volume of construction under way, and the rapid rise of automobile output, it virtually guarantees a high level of production for the remainder of the year or longer. Of course business, even during the armament program, will not be immune from fluctuations; there will be periods of unfavorable news as well as favorable, and of inventory liquidation as well as accumulation. However, the outlook is free from one uncertainty. Manufacturers engaged in defense work have no worries as to the market for their products. They are not dependent upon consumers' purchasing power and do not have to give thought as to whether their distributors are overstocked.

More construction work is going on than at any time since the middle of 1930, according to the contract awards compiled by the Dodge Corporation, which in August were 28 per cent above a year ago, and in the first half of September 21 per cent higher. Assembly of the new automobile models has been speeded up more sharply than in any previous season, due both to confidence that sales will increase further and to a policy of rushing output in case rising defense requirements should hamper production later.

To round out the picture, retail distribution has been better than many merchants expected. August weather stimulated early buying of Fall apparel, and the month was the best that retailers have had since 1930. September has brought little letdown, with department store sales running 10 per cent over last year. The wholesale merchandise markets generally have had a good month, due to reorders of Fall goods after the conservative early purchases.

Opinions of the Price Outlook

The price advances which have accompanied the commodity buying have been moderate, and the price index of twenty-eight staple commodities compiled by the Department of Labor at the end of the month was only 4.4 per cent above the low point in early August. This is hardly to be described as an inflationary move. Nevertheless, the question whether it marks the beginning of a general upward trend is of concern to everyone. The first comment to be made is that if buyers think a considerable price rise is coming it will almost surely occur. Fears of scarcity tend to bring on at least an appearance of scarcity, due to accumulations in inventories. Of course shortages due primarily to this cause are illusory, the higher prices are without sound foundation, and the miscalculations of the people who pay the prices are generally punished, in due course, by losses.

The armament program of this country, carried out in conjunction with British buying, involves vast purchases of industrial goods. It is natural that manufacturers should feel safer with good-sized inventories and commitments. It is also natural and desirable that prices of basic materials should advance in cases where production obviously needs stimulation, and where higher prices will permit higher-cost producers to operate. But it is wholly undesirable that there should be either hoarding or withholding of supplies. A general or inflationary price rise, running to any considerable extent, would be gravely disturbing. Almost the first effect of a rise in industrial materials would be to disrupt relations further between industrial prices and farm prices. It is argued that farm prices would necessarily move with industrial prices, due to ability of factory workers to buy more food. But this argument overlooks many points, the chief of which is that many farm prices are already pegged above their natural levels by government loans, and there is much slack to take up before a sound base for higher prices could be established. Similarly, a general price rise would stimulate wage rises, start a confusing spiral of advancing costs, and greatly retard the defense program as well as add to its cost.

The self-interest of buyers should lead them to study facts and make independent and balanced judgments of the commodity markets, rather than join in stampedes. If that is done the collective decision is likely to be a wise one and the price advances confined to places where more production is needed. There are many reasons for assuming that supplies of industrial materials, either actual or potential, are in almost every case sufficient, provided demand is orderly. Current indications of scarcity for the most part either are deceptive, because the commitments being made will likely lead to accumulation in inventories, or temporary, because more productive capacity can be put to work. During times of spectacular demand buyers tend to underestimate productive capacity, which when pressed may turn out larger than believed.

The Lumber Situation

Lumber is a commodity which has advanced in price, and which illustrates most of the points that need to be taken account of in the price situation. The lumber industry is highly competitive and sawmill costs vary considerably, and by providing a profit to higher-cost mills the higher prices will encourage a greater output, thus performing their natural function. The lumber situation is described as follows in a letter from a customer of this Bank:

For some years the sawmills of the country have been carrying very light stocks of manufactured lumber, and when the defense program began placing orders for large quantities, the stocks of the sawmills were soon exhausted. And, as is always the case, the

lumber dealers over the country, sensing that there would be an advance in the market, have been buying more freely than they usually do. Within the last few weeks some of the more popular items have advanced in price from an average of about $20.00 to $30.00 per thousand. The sawmills are not "geared" to expand their production as rapidly as the steel mills. Given a few months time, they will be able to increase their output very considerably; but for the immediate present, it is next to impossible to obtain certain items in any considerable quantity. For instance, some of the larger mills in the country are limiting the amount of some items that they will sell to any purchaser to five or ten thousand feet, whereas, of these same items, some of the defense program projects are calling for as much as one or two million feet.

It is to be hoped that the sawmills will soon be able to produce sufficiently to take care of at least the defense program and possibly all that the building trades of the country will require. With lumber prices advancing so drastically as they have, I can not see but that residential building over the country will be retarded. Unless FHA consents to increase its valuations of residences on the basis of the increase of the materials used in their construction, many prospective builders or home owners will not have sufficient cash to make the necessary cash payment of at least ten per cent.

This letter makes three points which may apply fairly generally. One is that lumber dealers have bought more than normally. The second is that, with time, production can be expanded. The Lumber Survey Committee, a body of experts which makes a quarterly report to the Department of Commerce, agrees with this statement. In its report released August 26 it estimates direct and indirect defense requirements of lumber and timber for the next twelve months at between 4 and 5 billion feet, which is less than 20 per cent of 1939 output or of the August rate of production (68 per cent of capacity). Production is now running ahead of 1939. The Committee says:

The lumber manufacturing industries can readily supply the timber products requirements of the national defense program. The present sawmill capacity is sufficient, if necessary, to provide an increased output of 40 per cent in softwoods and 50 per cent in hardwoods. The available timber resources are adequate for these purposes, and their protection is aided by gradually improved methods of logging.

The third point is the possible effect of higher lumber prices on building activity. If building is curtailed the lumber industry will not be the only or even the chief sufferer, considering the employment and support to general business given by construction work. Mr. Stewart McDonald, the Federal Housing Administrator, has announced that the F.H.A. will not permit its appraisals valuing new home construction to cover any "unjustifiable" increases in materials prices. This statement should influence buyers to consider the situation more carefully. However, it is pertinent to ask who is to interpret the word "unjustifiable" and by what standards? The essence of the matter is that greater production is needed. The markets themselves may be trusted to determine what prices are necessary to achieve the increase, and if there are temporary price excesses through miscalculation and misjudgment those who make the mistakes will soon pay for them.

Action by leading lumber manufacturers reveals a desire to avoid a runaway which might restrict their business or contribute to inflationary tendencies. The Weyerhaeuser Sales Co., announcing that its prices of key items were set on September 9 and will not be increased until increased costs or other reasons beyond control require it, also states that it is reserving its stocks on hand for government needs, while allocating its current production to other customers.

Steel Prices and Capacity

This desire to maintain orderly markets is general among producers. The steel manufacturers, with heavy backlogs and a strong demand, have reaffirmed prices for the fourth quarter at unchanged levels, and it is significant of the general view of the price question that no one expected them to do otherwise. This is the same policy that was followed during the boom in steel twelve months ago, and the reasons are the same; namely, to make a contribution toward keeping the general situation stable, and to set an example to other industries and to labor.

Authoritative opinions as to the ability of the steel mills to meet probable demands have been made public during the month, and they are generally assuring. The present ingot producing capacity of the country is calculated by the American Iron and Steel Institute at about 82,000,000 net tons, and the finished steel capacity at approximately 60,000,000 tons. Mills can be operated for a time at above capacity, but not usually for a long period. Production of finished steel in 1939 was 39,000,000 tons, and in 1929, the peak year, 46,000,000. Even should non-defense requirements equal the peak year, which for many reasons is hardly likely, there would be a theoretical margin of 14,000,000 to meet defense requirements and the abnormally increased exports. Estimates of defense requirements, according to the Institute, run between 12,000,000 and 15,000,000 tons, deliverable over a long period; this accords with an estimate by Mr. Edward L. Ryerson, Jr., Chairman of the Board of Inland Steel Co., that defense requirements will not be likely to exceed 6,000,000 or 7,000,000 tons in the peak year (1942).

These figures suggest that the steel industry will be operating near capacity over a longer period than ever before. Facilities for making armor plate and possibly a few other types need expanding. Otherwise, the opinion of the steel makers is that present capacity is adequate, although Mr. Irving S. Olds, Chairman of the United States Steel Corporation, has stated his belief that some system of priorities may become necessary. He properly calls attention to the benefits that will now be obtained from the increases in rolling mill capacity installed during the depression.

Non-Ferrous Metals Advance

The tight position in zinc, which has pushed the price up to 7¼ cents, had its origin in the

shutting off of the Belgian smelters from the English market. This has turned both supplies of foreign concentrates and demands for refined zinc to this country, imposing a strain on our smelting capacity. British Empire refining capacity is being fully utilized and new plants are being built. Meanwhile, zinc exports are currently running at approximately 100,000 tons annually, while an even larger amount of concentrates is being imported.

The American Bureau of Metal Statistics calculates the total zinc smelting capacity of the United States at 814,000 short tons a year. At present about 740,000 tons of this capacity is being used, leaving 74,000 tons unused. The heaviest domestic consumption on record was 634,000 tons in 1929. It will require time and money to get unused capacity into production, but reconditioning of three plants is reported under way. No large increase in smelter capacity is likely to be undertaken, for the foreign concentrates now coming here will naturally flow to Belgium again after the war.

Mr. Clinton H. Crane, President of the St. Joseph Lead Co., on September 12 made a speech to the convention of the American Mining and Metallurgical Engineers at Salt Lake City in which he pointed out these facts. He added that the amount of zinc being shot away as ammunition is small compared with that of 1915-16, and after surveying the figures he expressed the opinion that "the present demand is partly due to a fear of a future shortage with attendant higher prices and the consequent effort of many buyers to stock more than their immediate requirements."

Mr. Crane has a good record as a prophet, for at the outbreak of the war he calmed the lead market by pointing out that the pressure of foreign concentrates, deprived of their market on the Continent of Europe, would keep the domestic price down. He now says of lead:

> American consumption is apparently running at a sufficient volume to absorb United States mine production, plus the lead coming from the smelting of imported ores. There is no room in this market, however, at the present time for any of the large accumulation of pig lead which has been brought into the country in the form of pigs and bars. But any higher domestic price would undoubtedly see some or all of this material sold in our market.

The record buying of copper, which moved the domestic price up to 12 cents compared with an export price of only 9.90, also raises a question as to mining and refining capacity. The refining capacity of 1,572,000 tons annually exceeds by a comfortable margin our mine producing capacity of around 1,150,000 tons, to which must be added the amount of old scrap recovered, a variable figure. The largest domestic copper consumption on record was 1,160,000 tons in 1929; in 1939 the total was 800,000. We can offer no estimates of what copper requirements are likely to be after the defense program is under full swing. A reassuring fact, however, is that domestic production can be held for domestic requirements. Foreign copper supplies are excessive now that the Continent is blockaded, and the foreign markets are depressed; hence there is virtually no export demand for copper metal of U.S. origin. Exports of fabricated products can also be supplied by using foreign metal, inasmuch as the brass producers and other fabricators can obtain a drawback of the customs duty when the product is exported.

Evidence on the Inflation Question

In giving these commodity market details it is not our purpose to offer opinions as to prices, but to present evidence on the inflation question which may not be given its due weight by those who think chiefly in terms of demand, the supply of money, and the Government deficit. The evidence in the cases cited is that supplies will be sufficient if the demand is orderly. In other products the existence of surpluses is well known. Rubber and tin production are both heavily exceeding actual consumption, and prices are firm only because the outlook is disturbed by war and possibility of interference with shipments, and because government and possibly some private buyers are accumulating huge reserve stocks of both. The United States will need imports of wool, but there is plenty of foreign wool available. The grain and cotton situations require no description. South American products are still, as in June and July, cut off from the Continent of Europe.

The dreaded inflationary spiral can start with labor costs and finished goods prices, as well as with prices of raw materials. Most business men expect costs to rise, but thus far the tendency has not been particularly marked, for any increases in operating costs have been largely offset by the greater production over which fixed charges are spread. No responsible person has yet claimed that the defense program will absorb all, or nearly all, of the unemployed. But of course the critical question is not as to the over-all supply of labor, but the number of men with the right skills in the places needed. Training of skilled workmen and machine operators is going forward in many fields, and is one of the most necessary elements in the defense effort.

Discussions of inflationary dangers and of policies to guard against them should take account of the importance of the capacity to produce, and of order in the markets and in cost and price relations, as well as of fiscal and monetary measures. From any viewpoint, the imperative need is the greatest possible production and free flow of goods. It is needed for the success of the defense program; it is needed to put the unemployed to work; and it is needed because the only sound way to keep prices down and to avoid moving into the vicious spiral of inflation is to produce sufficient goods to satisfy the purchasing power which will be put in circulation by the Government's defense

financing. If production is insufficient the only defense left against inflation will be to repress consumption.

Much is being written about the self-denial that will be necessary to carry out the armament program. Clearly, when an important share of productive effort is devoted to providing armament, people cannot have as many other goods and services as they could have if the total effort were devoted to turning out the things used in everyday life. This, however, is not the practical view of the matter. The fact is that the output of the country is far below what it could be if all its labor, capital and technical abilities were efficiently employed. Thus while consumers must give up goods and services which they *might have,* it need not be true that they must give up things which they *have.*

If "self-denial" means harder work, by management, capital and labor, it is called for. The question is entirely whether the armament is carried out by *increasing* production and employment to full capacity, or by *diverting* manpower and capacity from present activities. In public policy more thought should be given to overhauling the measures which repress production; otherwise measures which repress consumption may have to be intensified or new ones established.

Much of the talk as to whether labor should retain its social gains is unrealistic. They cannot be retained by legislative fiat, but only through production.

The Tax Bill and Conscription

On September 19 the Second Revenue Act of 1940, more generally known as the excess profits tax and amortization bill, was passed by the Senate and at this writing is in the hands of the conference committee of both Houses of Congress. While the general opinion among tax experts seems to be that the Senate improved the bill on the whole as compared with the House version, the measure was still subject to widespread criticism for reason of its extreme complexity, to say nothing of such features as the Connally amendment proposed by the Senate and providing for a scheme of drastic taxation to go into effect automatically in event of declaration of war. Moreover, the question remains as to whether the present is an opportune time to vote additional taxes, considering the increases of $1,000,000,000 annually voted no longer ago than June.

The experience of the bill both in the House and in the Senate has amply justified the contention of those who argued that the matter of repealing the Vinson-Trammell act limitations upon profits of army and navy aircraft and navy shipbuilders, and of authorizing amortization of the cost of new plant facilities for handling defense contracts over five years, regarding which there has been little controversy, ought to be dealt with separately from the highly intricate and controversial problem of working out a just and workable program of taxing excess profits. As a result of trying to do the two jobs at once, Congress has done neither well. Under constant pressure to speed the passage of the Vinson-Trammell Act repeal and amortization sections, it has hastily devised a bill introducing an entirely new form of tax upon business. At the same time, due to the controversies over the excess profits tax features, action has failed to come soon enough to avoid costly delay in placing defense contracts.

At the time of our going to press, the principal features of the bill, as agreed upon in conference and summarized by the Washington correspondent of The New York Times, were as follows:

1. Increases the tax on normal income of corporations earning net profits of more than $25,000 a year by 3.1 per cent, making the effective rate 24 per cent.

2. Imposes the following additional graduated rates on "excess profits" on all corporations not specifically exempted:

On excess profits not exceeding $20,000, 25 per cent; on the next $30,000, 30 per cent; on the next $50,000, 35 per cent; on the next $150,000, 40 per cent; on the next $250,000, 45 per cent; on all over $500,000, 50 per cent.

Two Formulas Provided

3. Defines excess profits according to two formulas, of which the tax-paying corporation may take its choice. The two formulas are briefly as follows:

(a) "Average earnings"—All profits in excess of 95 per cent of the average earnings for the base period 1936 through 1939, inclusive, not more than one deficit year to be counted as zero in computing the average earnings of the base period.

(b) "Invested capital" — All profits in excess of 8 per cent of the taxable year invested capital, including all "equity" capital and 50 per cent of "borrowed" capital.

(c) "Exemption" — All corporations subject to the tax are allowed initial excess profits of $5,000, to be exempted from the levy.

4. Permits corporations with normal incomes of $25,000 or less to carry over the unused portion of the excess credit for a period of one year, provided the income during the second year does not exceed $25,000.

5. Allows parent corporations owning 95 per cent of all classes of stock of affiliates—except non-voting preferred—to file consolidated returns for itself and subsidiaries under rules and regulations to be prescribed by the Commissioner of Internal Revenue.

6. Gives authority to the Commissioner of Internal Revenue to make necessary adjustments of abnormalities relating to income or capital. The Commissioner's decisions to be subject to review by the United States Board of Tax Appeals upon application of the taxpayer.

Five Years for Amortization

7. Permits corporations building new plant facilities certified by proper governmental authorities as necessary for national defense to amortize the total cost of such facilities out of tax free earnings over a period of five years, provided such facilities are completed after June 10, 1940.

8. Suspends operation of the profit limitation of the Vinson-Trammell Act during the period of the emergency.

It is apparent that what started out as an effort "to prevent a new crop of war millionaires" has become a general revenue measure, increasing the normal tax paid by all corpora-

tions to a new high and levying "excess-profits taxes" upon many companies whose earnings have no relation to the defense program.

The conference committee is reported to have eliminated the Connally amendment added by the Senate, and to have decided that imposition of a schedule of drastic war taxes should better be deferred by Congress until such time as the country is actually at war. Another important amendment which was considered but not passed by the Senate was the Brown amendment, which would permit reciprocal taxation of the income from future issues of federal, state and local government securities, thus ending the tax-exempt feature which heretofore was enjoyed by such issues. Still other important changes are of course possible before final passage of the bill.

Selective Service Adopted

With the passage on September 14 of the Selective Service and Training Bill by a vote of 47 to 25 in the Senate and 232 to 124 in the House, the United States inaugurates its first peacetime military conscription. All male citizens or male aliens residing in this country who have declared their intention to become citizens, between the ages of 21 and 36, are rendered liable to call for a year's service, subject to certain exemptions named in the law or left to the discretion of the President. Except in time of war, no more than 900,000 inducted under the act may be in service at any one time, and service at all times is limited to the Western Hemisphere or United States possessions.

Pursuant to powers granted to him under the act, the President has named October 16 as the date of registration under the service law, estimated to affect some 16,500,000 men. Expectation is that not more than 800,000 men will be selected for training, — 400,000 by January 1 and an additional 400,000 by April 1. Together with the expanding Regular Army and Navy and the National Guard, which is being ordered into federal service, these increments will lift the armed forces of the country to well over 1,200,000 men.

The "Draft Industry" Controversy

One of the regrettable features of the passage of the draft act was the nature of some of the debate on the so-called "conscription of industry" section. As finally adopted, the bill provides, in effect, that unless manufacturers accept orders placed by the Government on terms named by the Secretary of War and the Secretary of the Navy as fair and reasonable the Government has the power to take over and operate the plants; and failure on the part of managers of industry to comply with any of the provisions of this section is punishable as a felony by imprisonment of not more than three years and a fine not exceeding $50,000.

An alternate and more moderate section had been proposed and rejected on the grounds that it took the "teeth" out of the compulsory features, and the more rigid version restored. Among the arguments advanced against the liberalized bill was that it "placed industry on a voluntary basis while placing men on the basis of conscription."

No one, of course, questions the right of the Government to commandeer private property when it is in the public interest to do so. This right is inherent in sovereignty and has been exercised time and time again by the Government in peace as well as in war. The point at issue is not the right itself, but rather the manner in which it is exercised. There must be assurance that the action taken is definitely in the public interest, that there be just compensation for damages, and that private individuals be protected against the arbitrary actions of some agency of government. All this is essential to the democratic principle.

"Human Rights vs. Property Rights"

Moreover, the analogy drawn between the draft of men and the draft of industry is not a true one. It is like the controversy over an alleged conflict between human rights and property rights, which is as old as the beginning of community life. Actually no such distinction exists, for the only "property rights" known to the law, or that can be debated, are *human rights in and to property*. Property is an inert thing, without knowledge of rights or capacity to claim them. Rights and claims are mental concepts, and exist only between beings who may have rival claims. Thus an attempt to set "property rights" over against human rights is only confused thinking.

One of the earliest developments of civilization must have been a common-consent agreement that each person should have the right to possess and keep whatever he had produced or won by his own labor, or had been the first to discover and utilize. Obviously such an agreement was necessary to social order, social amity, social unity and social progress; for no group, tribe or nation without it could survive against a rival united and strengthened by it.

Thus individual rights in property, instead of being opposed to either human rights or social progress, have been the necessary basis of both. The record of social progress shows that the countries in which the laws provide the most certain security to individual rights in property have been the countries having the highest standards of social welfare and of individual independence and character.

As for the draft industry argument, it is to be considered that the individual shareholders of the corporations are not exempt from the conscription which applies to corporation employes and other men. They are subject to personal conscription on the same terms, and in addition their income is being conscripted by the heavy taxes levied first upon the enterprises in which

they have an interest and again upon their own individual incomes. Nor do the shareholders have the satisfaction of knowing that the taxes all go for the national defense. Furthermore, it might be argued that a thoroughgoing application of the draft principle would conscript labor as well as capital, and of course this is not suggested.

Granted that the Government should have final authority over industry, if the emergency requires and providing there is proper regard for individual rights, the real question is, what is the most effective way of getting the job done? The Government is prepared to organize and direct an Army and Navy, for it has trained leaders for both, but the trained leaders for the industries are already with them, and the less the organizations are disturbed the more efficient they will be.

All responsible testimony is to the effect that industry is extending itself to the utmost to meet government needs, having due regard for the uncertainties of the situation, including the vital but unsettled matter of taxes. In fact in case after case industry has gone ahead without definite contracts and taken risks not ordinarily justified in order that the defense program might move forward where otherwise there would have been delay. Officials of the National Defense Advisory Commission have praised repeatedly the attitude of business, and in a recent address the Assistant Secretary of War, Robert P. Patterson, referred to "the cordial and wholehearted cooperation of the nation's industries," adding that "we are seeing no desire on the part of industry to make exorbitant profits."

British Empire Gold and Dollar Resources

The acceleration of British purchases in this country after the collapse of France is being reflected in our rapidly expanding exports to the United Kingdom. In August we shipped to Great Britain $125,000,000 of our goods, which was two and a half times that of three months before. The other countries of the British Commonwealth also have turned in increasing degree to this country for raw materials, parts for assembly, machinery and machine tools used in the manufacture of war materials for their own defense and for Great Britain. In August about $225,000,000 or nearly 65 per cent of our total exports went to the British Empire countries, and our sales to them were four times those to all of Latin America.

Because of inevitable disturbances in British industrial production and the extension in the scope of the war, British purchases are expected to increase still more as time goes on. While no official figures have been given out, press reports from Washington say that total orders placed here by the British Purchasing Commission reached the first billion dollars early in May, and the second billion at the time of the first anniversary of the war, with no more than $500,000,000 of the contracts estimated to have been delivered up to that time. In July some 225 planes and 1,250 airplane engines were reported to have been shipped, but next Spring this rate is expected to reach about 600 planes and 1,750 engines per month. The rate of exports of various steel products, excluding scrap, is said to have reached last month about 600,000 tons a month.

On the strength of this trend, and assuming that the foregoing figures are approximately correct, it has been estimated that by next Summer the British Empire may be taking about $315,000,000 worth of goods monthly, or about 70 per cent of our total probable exports at that time. If fulfilled, this would mean that the total of American exports to the Empire during the second year of war, from September 1940 to August 1941, would reach at least $3,000,000,000 as compared with about $1,800,000,000 in the first year of war and $1,290,000,000 in the calendar year 1938.

Prospects such as these raise a question, from the point of view of American business, as to the gold and dollar assets remaining available to the British Commonwealth of Nations.

Resources at the Beginning of the War

When the war broke out, the readily available resources of the British Empire, consisting of central bank gold reserves, dollar balances and American negotiable securities—all usable in this country as payment—amounted, according to a rough estimate by the Federal Reserve Board, to about $5,000,000,000. Their distribution will be seen from the table below. In addition, the so-called direct investments of British Empire countries in the United States, such as ownership of mines, oil wells, manufacturing enterprises and agricultural properties which are classed as less readily marketable, were estimated at $1,460,000,000.

British Empire Holdings of Gold, Dollar Balances and American Investments

(In Millions of Dollars)

Condition, August 31, 1939	United Kingdom	Canada	Other Empire	Grand Total
Central gold reserves	2,000	215	525	2,740
Dollar Balances	595	355	**	950
Negotiable securities (mkt. val.)	735	500	**	1,235
Total	3,330	1,070	525	4,925
Direct investments	900	560	**	1,460

** Not available, probably small. Arranged from the Federal Reserve Bulletin, December 1939.

Liquidation of Bank Balances and Securities

There are two possible methods of estimating the present size of the British Empire gold and dollar assets. One is to note the changes in the various items included in the above table during the first war year. Unfortunately there are too many gaps in the available statis-

tical information to come to any satisfactory conclusions by this method. While the central gold reserves of Canada, other Dominions and India rose from about $740,000,000 as of the end of August 1939 to about $800,000,000 a year later, there is no way to trace what happened to the largest of the items—the gold reserve of the United Kingdom proper, as all British gold was transferred to the Exchange Equalization Fund in September a year ago.

Our gold imports from the Empire countries, which ordinarily could supply a clue, amounted to over $3,500,000,000 during the first year of the war, or nearly $1,000,000,000 more than the sum of the gold holdings of the Bank of England at the outbreak of the war plus the exportable share of Empire output of newly mined gold, which is running at present at the rate of about $750,000,000 per year. The size of these shipments is due to the fact that gold imports from London or through Canada included also French, Belgian, Dutch and Scandinavian gold reserves. Moreover, a considerable part of the gold received here during the first war year still belongs to foreign central banks, as is apparent from the rise of the gold stock under earmark at the Federal Reserve Banks from $1,135,000,000 at the outbreak of the war to $1,760,000,000 a year later; but no figures are available to show which countries, or in what amounts, own the earmarked gold.

The changes in bank balances and American negotiable security holdings may be roughly established from the United States Treasury figures on international capital movements, as has been done in the table below. Published with a three months delay, the Treasury figures show that during the first ten months of war Great Britain and Canada drew upon their dollar bank balances here to the extent of $197,000,000 and $96,000,000 respectively, reducing their estimated holdings from $595,000,000 to $398,000,000 for Great Britain and from $355,000,000 to $259,000,000 for Canada.

U. S. Gold Imports from the British Empire and Changes in the Empire Dollar Bank Balances and Security Holdings

(In Millions of Dollars)

		U.S. Gold Imports From United Kingdom	Canada	Other Empire**	Sales of U.S. Securities U.K.	Canada	Bank Balances U.K.	Canada
Sept.	1939	162	121	10	– 25	–4	657	325
Oct.	"	10	10	13	– 48	–5	600	321
Nov.	"	19	65	33	– 22	–3	501	328
Dec.	"	10	309	24	– 10	–4	468	285
Jan.	1940	24	53	36	– 12	–8	404	267
Feb.	"	21	47	29	– 9	–1	376	269
Mar.	"	35	250	44	– 16	–1	361	250
Apr.	"	44	55	34	– 5	–	327	255
May	"	62	281	41	– 5	–4	354	236
June	"	128	717	82	– 3	–7	398	259
July	"	302	172	11				
Aug.	"	11	264	23				
Total		828	2,344	330	–155*	–32*	197*	96*

*Total for ten months only. **South Africa, India and Australia only.

Note: Minus sign denotes decrease in foreign owned American securities.

During the same ten months' period (September 1939-June 1940) Great Britain sold on balance about $155,000,000 worth of American negotiable securities and Canada sold $32,000,000. Altogether Great Britain and Canada reduced their combined total of dollar bank balances and American negotiable securities by about $480,000,000 in the September 1939-June 1940 period.

The Balance of Payments Between the United States and Great Britain

Another and more satisfactory, although likewise incomplete, method of estimating the net drain upon the Empire resources during the first year of war is to make a rough calculation of the balance of payments between the British Empire and the United States. As shown by the table below, we sold to the Empire about $1,800,000,000 worth of merchandise in the year ended August 1940, of which the United Kingdom took about $785,000,000 or 43 per cent. Of our imports from the British Empire for the first war year, amounting to about $1,100,000,000, all but $165,000,000 represented imports from Empire countries other than the United Kingdom, illustrating the vast triangular exchange of goods on which our economic relations with the Empire are based.

United States Trade with the British Empire

(In Millions of Dollars)

	Calendar Years 1937	1938	First Year of War*
Exports			
United Kingdom	534	521	785
India & Crown Colonies	129	113	160
Total	663	634	945
Canada	510	468	660
Other Dominions	199	189	185
Total Empire	1,372	1,291	1,790
Imports			
United Kingdom	203	118	165
India & Crown Colonies	436	228	420
Total	639	346	585
Canada	399	260	410
Other Dominions	82	33	75
Total Empire	1,120	639	1,070

* Imports estimated on the basis of figures for 11 months — September 1939 — July 1940.

On the basis of these figures, we accumulated during the first year of the war an export surplus of about $700,000,000 in our trade with the Empire, compared with an export surplus of $650,000,000 for the calendar year 1938 and only $250,000,000 in 1937.

As to "invisible" items, there is no way of knowing precisely what effects exchange control and war have had upon interest and dividend remittances on our investments in the Empire, which in 1937 brought in about $125,000,000. Nor do we know how greatly the expenditures of American tourists or earnings of the British merchant marine and commission

houses declined during the first year of war, although it is obvious that tourist expenditures have practically ceased.

Since many of the invisible items in peacetime have tended to offset each other, it may be assumed that they do not distort greatly even in war time the balance of payments based only on merchandise figures. However, much greater difficulty lies in making allowances for advance payments on orders and plant construction in this country. As a result of these, the actual drain on British resources has probably been greater than the balance of payments on goods actually shipped may indicate. On the other hand, advance payments already made will reduce the amount of dollars necessary to pay for merchandise shipments in the future.

Gold Output Equalled Unfavorable Trade Balance

The most striking fact revealed by examination of the figures is that the Empire's output of newly mined gold, amounting to $750,000,000 during the first year of war, more than offset the Empire's $700,000,000 unfavorable balance in merchandise trade in the same period. It does not follow that the entire output of new gold was available for shipment to this country; and the reduction of $480,000,000 in dollar balances and security holdings in the first ten months of the war is probably evidence that merchandise trade balance substantially understates the British payments made here. Nevertheless indications are that gold production relieved the strain on the available gold reserves and dollar assets to a greater extent than may be generally realized.

Looking ahead, our imports from the Empire will undoubtedly rise as a result of better business and our rearmament program, particularly through purchases of rubber and tin for reserve stocks. The Empire's purchases from us, however, are likely to rise at a faster rate. Should they reach a figure of $3,000,000,000 to $3,500,000,000 during the second year of war, as has been suggested, the trade balance will be much more unfavorable and the drain on the gold and dollar resources consequently much greater. With this prospect, the indications that the actual drain on these resources during the first year, exclusive of the advance payments, has been relatively small are encouraging. Allowing for the roughness of the calculation, the conclusion is warranted that only a comparatively small part of the $5,000,000,000 of liquid dollar assets and gold held at the beginning of the war has been paid out, and that the ability of the Empire to finance heavy purchases here is not yet strained.

The extent to which Great Britain has maintained her exports, even since the German air attack, and despite the loss of Continental markets, is a notable achievement. The August exports at £32,554,000 were only £4,600,000 below a year ago.

Prices Fixed for Bituminous Coal

On October 1st, after long delay, the official schedules of minimum prices for every kind, quality and size of bituminous coal were put into effect, under the provisions of the Bituminous Coal Act of 1937. For administration and enforcement, the act established a National Bituminous Coal Commission, but the Reorganization Act of 1939 abolished this Commission and transferred its functions to the Bituminous Coal Division in the Department of the Interior.

The law provided for the organization of a "Bituminous Coal Code," with membership open to all producers of bituminous coal in the United States, but also requiring compliance by wholesalers and selling agents, but not retailers. All members are bound to comply with the code, including minimum prices, marketing rules and other regulations promulgated by the Division, and any violator is subject to expulsion from the code, injunction by the courts, and to suit for triple damages sustained by other code members. In addition, any nonmember of the code is subject to an excise tax of 19½ per cent on all coal produced and sold. An excise tax of 1 per cent is levied upon all producers for the cost of administering the code.

It is admittedly the purpose of the act to legally permit, and in fact force coal producers and distributors to fix minimum prices and limit competition—in other words, to do what the anti-trust laws have for years forbidden and what the Department of Justice and the Federal Trade Commission have often prosecuted. The reversal of policy in the case of coal, and the undertaking of government regulation over prices and trade practices, are designed to stabilize and improve conditions in this major industry which has experienced so many troubles during the past twenty years.

Whether the plan will be workable, whether it will succeed in bringing lasting benefit to the coal industry, and whether the higher prices will affect seriously the consumption of coal, are among the many important questions raised by an undertaking of this scope.

Changes in the Coal Industry, 1920-1940

Coal mining was greatly expanded during the first world war, as were other industries, and the subsequent readjustment has kept conditions depressed ever since. The surplus mines, surplus miners and the vast reserves of coal in this country have caused keen competition for the market and held prices at such a level that large numbers of producers have been operating at a loss ever since the war. Moreover, the market for coal, unlike most other basic products, did not resume its former long-term upward trend, but lost business to competing fuels and water power.

Fuel oil has cut deeply into the consumption of coal for industrial, commercial and residential heating, while the improvements of the Diesel engine using fuel oil have stimulated the introduction of such engines as a source of power for shipping, railroads, industry and small utility plants.

Rising efficiency in the use of coal has brought about a proportionate reduction in consumption of coal per unit of work. Consumption of coal by steam locomotives in freight service, measured in gross ton-miles, was reduced between 1919 and 1938 by 32 per cent, while the consumption in passenger service was reduced during the same period by 19½ per cent, measured in passenger-train car-miles. Iron and steel mills reduced their blast furnace consumption of coking coal per ton of pig iron by 20 per cent. Electric public utility power plants, using higher-pressure boilers and improved turbo-generator units, reduced their consumption of coal per kilowatt-hour by no less than 56 per cent. In residential and commercial heating also, improvements in the design of furnaces, boilers, stokers and heat-regulating equipment have made substantial reduction in the consumption of coal.

Another factor which has affected the consumption and prices of coal is the relatively high freight rates. In 1937, the latest year for which official figures are available, the national average gross realization to the producer of coal (including selling expenses) was $1.946 per ton f. o. b. mines, whereas the average freight charge in that year was $2.17 per ton.

The relatively high labor costs prevailing since 1920 have held costs of production high and thereby hampered the industry in its efforts to meet the competition of other fuels. Moreover, labor troubles have caused tremendous losses to both operators and miners, district strikes having occurred in every year since the war. These have repeatedly threatened, and frequently cut off the supply of coal to consumers, causing serious losses to many and inconvenience to all.

Increased taxation in recent years, which has affected all lines of business, has burdened the coal industry particularly because of the high proportion of wages to total costs (around 60 per cent). The old-age benefit taxes, unemployment compensation taxes, coal excise taxes, local property taxes and others are not based upon net income, but must be paid even if the business is operating at a deficit. In 1937, a relatively good year for business, the Pittsburgh Coal Company — the largest individual producer — showed sales of $47,878,579, taxes of $2,413,903, a net deficit of $1,036,330, and no dividends paid on either its preferred or common stock representing an equity of $109,652,265. Taxes were equivalent to 20 cents per ton of coal produced, and to $159 per employee.

Under the pressure of shrinking markets, the industry has made remarkable progress in the methods of mining coal and its preparation for marketing. During the past twenty years, and especially during the past ten, there has been a large increase in the use of machinery for (1) coal-cutting in the mines, (2) coal loading by mobile loading machines, scraper loaders and conveyors, (3) coal cleaning, sizing and preparation, and (4) stripping by steam and electric shovels in open-pit mines. Today 85 per cent of all coal from underground mines is cut by machine, and the portion loaded by machine, although much smaller, is increasing rapidly.

Use of machinery in these operations has greatly reduced the hard manual labor involved, increased the productivity per worker, and helped management to offset (at least in part) an increase in labor costs, taxes and other expenses.

Previous Attempts to Fix Prices

During the war, and as a war emergency measure, the Federal Government created the United States Fuel Administration for the purpose of regulating both prices and distribution of coal. In 1933, under the National Industrial Recovery Act, a Bituminous Coal Code provided for maintenance of minimum prices and elimination of unfair competition practices, but became inoperative in 1935 when the NRA was declared unconstitutional.

This led to the Bituminous Coal Conservation Act of 1935 (often referred to as the Guffey-Snyder Coal Act, or the First Guffey Act) which created a National Bituminous Coal Commission, prohibited the sale of coal below minimum prices approved by the Commission and provided for taxes to enforce compliance. This act was declared unconstitutional in 1936.

In the case of each of these attempts, when the control was removed and the artificial support withdrawn, there was a decline of prices and the basic conditions in the industry were aggravated.

A revised bill, known as the Bituminous Coal Act of 1937 (Second Guffey Act), as described briefly at the beginning of this review, was passed in April 1937. Acting under this law, the Coal Commission ordered a schedule of minimum prices put into effect in December 1937, but court injunctions were issued against enforcement of these prices, on the ground that interested parties had not been given adequate hearing as required by law, and the schedule was revoked in February 1938.

Thereafter the Commission instituted an exhaustive series of hearings for all districts in the country, at which appeared representatives of producers, labor, and consumers, also federal, state and local government officials. New schedules of minimum prices, based upon average costs of production, were determined from these hearings and from cost records submit-

ted by producers, and were ordered by Secretary Ickes to take effect on October 1st.

Enforcement and Other Problems

The magnitude of the problems involved in establishing minimum prices and regulating trade practices in bituminous coal is due to the complexity as well as size of the industry. Bituminous coal is produced by more than 6,500 active commercial mines, located in more than 30 different States, turning out 400,000,000 or more tons annually and possessing reserves adequate to last hundreds of years. Also large numbers of mines are closed down at present but could resume operations if prices rise.

There is wide variation in the size of coal mines, in qualities and occurrence of coal, in costs of production, in accounting practices, in transportation costs, in character of markets and in classes of consumption. Coal prices must stand in fair relation to prices of all competitive fuels, giving due consideration to comparable grades and sizes, and to comparative costs of operating equipment. Even for coal alone, there is considerable latitude for shifting to coal of a different analysis, size or origin. For these reasons, the complex interrelationship of prices which has grown up over a long period of time involves delicate balance.

The law specifically provides that the Coal Division must take account of all these factors in its determination of minimum prices. In order to assemble all the essential information the Division conducted a series of hearings, and the individual cost records submitted by producers for the year 1936 and the first nine months of 1937, numbering over 90,000, were tabulated and analyzed. After a tentative scale of prices had been drawn up and coordinated, the Division held a final hearing which it stated "is probably the most extensive administrative proceeding ever undertaken by any government agency." A transcript runs to 18,595 pages and is supplemented by almost 1,200 exhibits.

The complexity of the task is illustrated by the fact that the work has been under way ever since April 1937, and the code prices, as determined from the exhaustive hearings and records prescribed by law, were not put into effect until October 1, 1940. Moreover, all of this material must be kept up to date. Adjustments in the official prices may be made at any time, according to law, if evidence conclusive to the Division is presented showing material changes in average cost of production or other factors.

Another formidable task will be the enforcement of official prices and marketing regulations among the 12,000 members of the code, including wholesalers, selling agents, marketing agencies, brokers, etc.

The scope, complexity and time involved in determining and constantly revising the multitude of different but related prices, and the conflicting nature of the testimony upon which they are based, have caused many experienced coal people to express doubt whether such a program could possibly succeed, although others feel that such a program is the only possible solution or is at least worth a trial.

Apart from the question of complexity, the program is open to criticism on two other grounds. First, it reflects the lack of a national policy in dealing with the basic industries. At the present time the Government is prosecuting the major petroleum companies for alleged control over prices in their efforts to eliminate excessive price-cutting and sales below cost, yet in the case of the coal industry is following the opposite policy by enforcing such control.

Secondly, instead of seeking to improve conditions in the industry through lowering costs and expanding volume, the program endeavors to maintain prices on the assumption that the present market will remain constant. An example of the danger involved in the latter method is cotton, where the efforts to improve the condition of cotton growers by artificial maintenance of prices during recent years has resulted in the permanent loss of a substantial portion of the foreign market for American cotton. The consequences of a price control program for coal are especially dubious in view of the highly competitive relation to oil.

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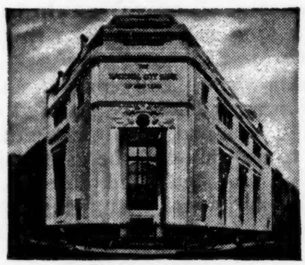

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